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TAGS: ECON ETRD EIND EFIN PGOV IMF RO
SUBJECT: ROMANIA: REVISED BUDGET FACES POLITICAL HURDLES

REF: A) BUCHAREST 563 B) BUCHAREST 573

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¶1. (SBU) Summary. Following revisions to Romania's accord with the IMF (ref A), the Government of Romania (GOR) has formally approved changes to its budget to reflect new fiscal realities. This second budget "rectification" of the year allows the projected 2009 deficit to surge from 4.6 to 7.3 percent of GDP. Despite the higher deficit, the GOR will still have to slash expenditures to adjust to the grim reality of declining tax revenues caused by sharply negative economic growth. Most ministries will see their budgets cut, with personnel expenditures to be reduced by 15.5 percent between September and November, largely through the use of mandatory furloughs (ref B). The jury is still out as to whether or not enough political will exists to carry out the public sector reforms mandated by the IMF. End summary.

¶2. (SBU) On August 29 the Cabinet of Prime Minister Emil Boc approved the second budget rectification of the year, following the outlines of the IMF staff agreement (ref A). The deteriorating fiscal outlook has forced the projected 2009 budget deficit up to a whopping 7.3 percent of GDP. While much of the blame is attributable to the depth of the recession, which has surprised most analysts including the IMF, GOR budget decisions taken in 2008 are also driving the deficit. At the same time that tax revenues for January-August 2009 fell by 6.9 percent of GDP, compared with the same period in 2008, public sector wage and pension increases along with other commitments made in 2008 actually pushed spending up by 7.4 percent in the same period.

¶3. (SBU) In full crisis mode, the GOR has started slashing budgets across the board, with most ministries forced to accept reductions of up to 14 percent from the previous allocations made in April. Immediate cuts are expected to total approximately 1.4 billion RON (470 million USD). Certain key programs escaped the fiscal scalpel, however, with the Ministries of Economy, Interior, and Justice all receiving minor increases. According to Ministry of Finance (MoF) Director for Macroeconomic Analysis and Financial Policies Dorin Mantescu, the budget rectification includes a 0.2 percent-of-GDP increase in capital expenditures (chiefly infrastructure investments), to be offset by personnel cuts. Bonuses for public sector workers are on the chopping block, and formerly independent and self-financing state institutions are being forced to return all income to the state treasury.

¶4. (SBU) Most controversial among the announced measures are mandatory ten-day furloughs and long-term wage freezes for some categories of public workers. Ministers have been directed to achieve a 15.5 percent reduction in personnel expenditures in the next three months, infuriating public sector unions. Hoping to set a good example of shared sacrifice, Cabinet members have agreed to cut their own salaries by 20 percent through the end of the year.

Tough talk from the unions, however, jeopardizes the other IMF priority, passing a unitary salary law that sets transparent wage rates across the government. After 12 drafts, the GOR and unions are still far from a common position on this legislation despite the GOR's pledge to "assume responsibility" for the bill in Parliament on September 15. If the GOR goes ahead, unions are threatening a general strike for October 5.

¶5. (SBU) Additional major staff cuts are expected in local governments, though likely not until after the presidential elections. Mantescu of MOF hopes that layoffs will target surplus municipal employees rather than the short-staffed public education and health systems. Pension reform is also on the agenda, although political consensus on how best to accomplish it is still absent. One logical step would be to eliminate the special status of military and intelligence services personnel, who are eligible to collect state pensions but currently pay no social security contributions. Resistance to such reforms from the affected groups will of course be fierce.

¶6. (SBU) Comment. Some commentators have observed that the number of public sector workers in Romania is not excessively high relative to the size of the population when compared with other EU member states. The real problem lies with public sector organization, training, and productivity. By most measures, government worker productivity has been stagnant or falling in recent years at the same time that public sector wages were rising by double digits. If the GOR focuses exclusively on cutting employees, without a system to retain the best workers while weeding out the dead weight, then Romania will derive no long-term benefit from the current exercise and essential government services will suffer. End Comment.

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